

Borrowing Needs

Background

During the past decade, LEAs have experienced a growing need for additional resources to finance facility expansions and renovation projects and technology-related initiatives. These projects often are financed through the use of various debt instruments that allow long-term financing of current capital expenditures. They also may be financed through the use of fund balance designations or current operating resources.

Capital needs of LEAs currently are addressed through a number of different methods across the U.S. Based on state statutes, four primary methods exist for providing capital financing for LEAs including:

- The state grants LEAs the authority to incur long-term debt for capital financing purposes. Debt is incurred by the LEAs based on the individual borrowing abilities of LEAs. Thus, the financial condition of the LEA is a primary determinant of its ability to finance long-term debt. However, long-term debt issuance often requires approval from voters within the jurisdiction and often is subject to state-mandated debt limits (e.g., a percentage of assessed property valuation).
- LEA capital needs are combined with those of some other local government entity, and long-term debt is issued by the other local entity. A local government (city or county) typically is granted the authority by the state to incur long-term debt. As a result, the financial condition of the city or county is a key determinant of the ability to finance long-term debt.
- LEA capital needs are addressed by the state. LEAs draw on a designated pool of state financial resources to finance capital projects. Thus, no long-term debt is issued at the local level. Typically, the states allocate these resources on a per pupil basis or through some other formula (e.g., based on age and number of facilities).
- LEA capital needs are addressed through a combination of state and local resources.

The growth of capital needs has resulted in a number of issues for LEAs. In some jurisdictions, the needs for capital resources significantly exceeds the LEAs ability to incur debt. Further, LEAs may not be receiving enough resources to address facilities needs due to the lack of local government debt capacity or a lack of state resources. As a result, LEA facilities and the related educational physical environment may be deteriorating to an unacceptable level.

Accounting Treatment

Current GASB reporting requirements do not require governments to account for capital borrowing needs. In fact, borrowing needs do not result in an accounting transaction or event to be captured in the financial statements of the LEA or SEA. This issue appears to be a local and state policy issue rather than one that requires revisions to the current Handbook. Based on this analysis, the issue of borrowing needs should be revisited at the

next Information Committee Meeting. We need to ensure that the issue has been properly defined and that no other concerns in this area exist.

The new GASB requirements do not address the borrowing needs of governments. Statement No. 34 does, however, address the issue of aging facilities. Under GASB Statement No. 34 governments will be required to depreciate all capital assets and report on the physical condition of infrastructure. Thus, if an LEA is not maintaining its capital assets properly (including facilities), the related depreciation expense may result in the reporting of a deficit in the LEAs financial statements. This requirement does not directly address borrowing needs per se; however, it does improve a financial statement user's understanding of the underlying asset maintenance issues of the LEA.

The borrowing needs of an LEA may be a topic that is discussed in the new Management's Discussion and Analysis (MD&A) section of the annual audit report (required by GASB Statement No. 34). The MD&A must be based on known facts related to the present financial condition of the LEA. This requirement limits the inclusion of information on projected capital financing needs; however, information related to current debt issuance and capital projects could be included in the MD&A.

Proposed Handbook Revision

None.

Coding Examples

Not applicable.

Other Issues

During the review of the proposed Handbook revisions, the need for additional guidance to LEAs concerning the proper coding of short-term borrowing proceeds was identified as a concern. Some LEAs are apparently coding short-term borrowing proceeds as revenue. Thus, revenues for the LEA are overstated due to the misclassification of the loan proceeds. We recommend the following Handbook revision:

“Short-term debt proceeds should *not* be classified as revenue. When an LEA issues short-term debt (debt with a duration of less than 12 months) that is to be repaid from governmental funds, a liability (notes payable) should be recorded in the balance sheet of the fund responsible for repayment of the debt.”

This note should be included in the Handbook at the beginning of the section entitled **Classifications of Revenue and Other Fund Sources** on page 78.